

Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. (This is a GIL).

May 1, 2001

Dearxxxx:

This letter is in response to your letter received March 5, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

In trying to refinance our equipment, our banker found an sales tax error, and we need you to please review it, and advise us, how to proceed. We purchased 3 pieces of equipment on 11/11/93 (see attached receipt), and paid \$1,359.88 in sales taxes. Our original payments were \$599.89 (see attached Bankers paperwork). After making the first payment, they increased our payment to \$658.42 to include sales tax. We made 24 payments of \$658.42, which is a total of \$1,404.72 in sales taxes. After we already paid sales tax on the equipment. We brought it to their attention, but they ignored us. We refinanced the equipment in 5/97 and again we brought it to their attention, and they ignored us. And again our payments as per the terms agreed were \$340.00. After making 3 payments, they then increased out payments to \$365.00 a month to cover sales taxes again. We have now made 45 payments of \$365.00, which is a total of \$1,125.00 paid in sales taxes again. We are nearing the end of our agreement, and before paying this equipment off, we would like to resolve this matter. Please call me and explain to me why we had to pay sales taxes 3 times on this equipment.

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the

property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

In regards to sale/leaseback situations, typically customer A purchases equipment from retailer B, and then sells it to lessor C who leases the equipment back to customer A. Customer A has paid tax when purchasing the equipment in the first transaction under a taxable retail sale and the second transaction (customer A's sale to lessor C) is a nontaxable occasional sale so long as A is not otherwise in the business of selling like-kind property. The third transaction (the leaseback of the equipment from lessor C to customer A) is not taxable because, as noted above, Illinois does not impose a sales/use tax on rental receipts with the exception of automobiles rented for a period of one year or less.

In general, no special documentation is required for any of the sale/leaseback transactions. In transaction 1 (sale from retailer B to customer A), retailer B would include the gross proceeds from its sale to customer A on its monthly sales tax returns and customer A would retain an invoice showing it paid tax to retailer B. In transaction 2 (sale from customer A to lessor C), it may be wise to document, on the invoice to lessor C, the fact that customer A is not otherwise in the business of selling like-kind equipment and that the sale is a nontaxable occasional sale. Transaction 3 (leaseback from lessor C to customer A) requires no documentation because rental receipts under true leases are not subject to Illinois sales tax liability (again, except automobiles rented for one year or less). The sale/leaseback transaction is not generally used with a conditional sale because there is no statutory mechanism to provide a credit for tax customer A properly paid in its previous purchase from B. If a sale/leaseback is used in conjunction with a conditional sale, tax will be due when lessor C conditionally sells the equipment back to A. To avoid this result A would need to lease the equipment from C under a true lease rather than a conditional sale.

It appears that the 1993 lease attached to your letter was a conditional sale. Even with that being the case, the property does not appear to have ever been located or used in Illinois. Consequently, it does not seem that either a sale or a lease of tangible personal property ever took place in Illinois. This being the case, no Illinois tax was ever due. We cannot, on the limited information presented and in the context of a general information letter, confirm this, however.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.